



# REPORT OF THE INSPECTOR GENERAL

AUDIT OF THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS  
FISCAL YEARS 1996 AND 1995 FINANCIAL STATEMENTS

OIG-97-094

JULY 09, 1997



**Office of Inspector General**

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**United States Department of the Treasury**

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To the Director of the Bureau of Alcohol, Tobacco and Firearms

We have audited the Statements of Financial Position of the Bureau of Alcohol, Tobacco and Firearms (ATF) as of September 30, 1996 and 1995, and the Statement of Operations and Changes in Net Position for the year ended September 30, 1996. Our audit scope with respect to ATF's Fiscal Year 1995 financial statements was to report on the Statement of Financial Position as of September 30, 1995. Accordingly, we did not attempt to audit, and we did not report on, ATF's Statement of Operations and Changes in Net Position for the year ended September 30, 1995.

This report presents our unqualified opinion on the Statements of Financial Position of ATF as of September 30, 1996 and 1995, and the Statement of Operations and Changes in Net Position for the year ended September 30, 1996. Our audit disclosed no material weaknesses in the internal control structure and no instances of reportable noncompliance with laws and regulations.

This report also describes our responsibility for auditing these statements, and management's responsibilities for financial reporting, maintaining an internal control structure, and complying with certain applicable laws and regulations.

## AUDITOR'S RESPONSIBILITIES

We conducted our audits in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We obtained an understanding of the internal control structure. Specifically, our consideration included obtaining an understanding of significant internal control policies and procedures; assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances; and performing tests of the internal control structure.

Our evaluation of controls for performance information contained in the Overview of ATF was limited to controls designed to ensure the existence and completeness of the information presented. The Overview of ATF is defined on page 2.

We have, as part of our audit, performed tests of ATF's compliance with certain laws and regulations that may directly affect the financial statements. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such laws and regulations.



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### MANAGEMENT'S RESPONSIBILITIES

Management is responsible for:

- Preparing the financial statements in conformity with the accounting standards described in Note 1 to the accompanying financial statements, and for preparing the Overview of ATF.
- Establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the benefits and related costs of internal accounting policies and procedures.
- Complying with laws and regulations applicable to ATF.

### OPINION ON THE FINANCIAL STATEMENTS

The financial statements of ATF referred to above were prepared in accordance with the accounting policies described in Note 1 to the accompanying financial statements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of ATF as of September 30, 1996 and 1995, and the results of its operations and changes in net position for the year ended September 30, 1996, in conformity with the accounting policies described in Note 1 to the accompanying financial statements.

Our audit scope with respect to ATF's Fiscal Year 1995 financial statements was to report on the Statement of Financial Position as of September 30, 1995. Accordingly, we did not attempt to audit, and we did not report on, ATF's Statement of Operations and Changes in Net Position for the year ended September 30, 1995.

### OVERVIEW OF ATF

In this report, we refer to the information in the following parts of the FY 1996 Annual Report as the Overview of ATF:

- Executive Summary and Highlights
- Organizational Profile
- Program Discussion and Analysis
- Financial Discussion and Analysis

Our audit was performed for the purpose of expressing an opinion on ATF's September 30, 1996, and 1995 financial statements referred to above. The information contained in the Overview of ATF is not a required

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part of the financial statements but is supplementary information required by OMB Bulletin No. 94-01, *Form and Content of Agency Financial Statements*. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

## INTERNAL CONTROL STRUCTURE

In planning and performing our audit of ATF's financial statements as of September 30, 1996, and for the year then ended, we obtained an understanding of its internal control structure. Specifically, we obtained an understanding of the design of relevant policies and procedures and whether they had been placed in operation; assessed the level of control risk relevant to all significant cycles, classes of transactions, or account balances; and performed tests of the internal control structure to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion. Our evaluation of the controls for performance information contained in the Overview of ATF was limited to controls designed to ensure the existence and completeness of information presented.

The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- transactions, including those related to obligations and costs, are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements that OMB, ATF management, or the Office of Inspector General have identified as being significant for which compliance can be objectively measured and evaluated;
- funds, property, and other assets are safeguarded against loss from unauthorized use or disposition;
- transactions are properly recorded and accounted for to permit the preparation of reliable financial statements in accordance with applicable accounting policies and to maintain accountability over the assets; and
- data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

We noted certain matters involving ATF's internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect ATF's ability to ensure that the objectives of the internal control structure, as previously defined, are being achieved.

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A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We summarized below the reportable conditions identified during our audit. We provided ATF with a document which discusses each of the conditions in more detail and provides specific recommendations on actions ATF should consider taking.

### **Strengthen Controls Over Personnel/Payroll Processing**

During our testing of the payroll system, we identified several instances where one or more of the following conditions existed: (1) required Thrift Savings Plan contributions of 1 percent of gross pay to employees did not begin during the correct period; (2) supporting documentation could not be provided for personnel/payroll transactions because tax and benefit forms were missing; (3) State income tax deduction formulas provided by ATF did not support the state tax deductions reflected in the payroll database; and (4) required authorization signatures were not documented on time and attendance records. In addition, we noted that the processing of personnel/payroll transactions is not independently verified for accuracy.

ATF did not identify and resolve in a timely manner, significant differences between the payroll balances in the general ledger, the National Finance Center's Abstract of Transactions and the TFS-6653 (Undisbursed Appropriation Account Ledger). At year end, management properly reconciled the payroll cash account balance.

### **Improve Procedures to Record Property and Equipment Disposals Timely**

During our testing of property and equipment, we noted that documentation supporting disposals of approximately \$1.3 million made at the end of the year was not provided to the Property and Fleet Management Section timely. Consequently, these property and equipment disposals were not recorded in the general ledger as of September 30, 1996. As a result, property and equipment, accumulated depreciation, and depreciation expense balances were misstated in the general ledger to the extent that they included assets that were disposed of before year end. During the course of the audit, ATF properly recorded the \$1.3 million of property disposals in the general ledger and reflected the changes in the Fiscal Year 1996 financial statements.

### **Strengthen Controls Over the Federal Excise Tax Database**

Our testing of the payment records of 88 taxpayers indicated that the Federal Excise Tax database contained certain incorrect taxpayer information. The database listed two payments with incorrect employer ID numbers and three payments with incorrect registry numbers. Furthermore, in three instances the database



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was not updated for the receipt of returns mailed to the North Atlantic and Western District Technical Services offices instead of the lockbox depositories. Significant delays in the recording of Non-Entity tax collections may result in an understatement of Non-Entity revenue.

### **Consider the Rotation of Inspectors in the Inspection Targeting Program**

The Inspection Targeting Program is integral to ensuring that the proper amount of excise tax is paid to ATF. A key element of that program is the inspectors' review of taxpayer operations. Inspectors may be assigned to perform the reviews of the same taxpayer for several years. Long term assignment to the same entity could be construed as an impairment of the inspector's objectivity or independence. Currently, there are no bureau-wide directives requiring the rotation of inspectors. ATF should give appropriate consideration to implementing policies and procedures requiring periodic rotation of inspectors in the Inspection Targeting Program.

### **Improve Controls Over Accountability for Seized Property**

During the performance of our year-end seized and forfeited property inventory observation and testing of internal controls, we identified the following conditions:

(1) Consolidated Assets Tracking System, ATF's system to record and report seized and forfeited property, was not updated timely with seizure, movement, or disposal actions; (2) Three ATF field offices did not perform fiscal year-end physical inventories of seized and forfeited property in their custody; and (3) ATF was unable to support the Net Adjustments recorded during Fiscal Year 1996 to the September 30, 1995 balances of seized and forfeited property. Due to the sensitive nature of seized and forfeited property, strong internal controls are essential to maintaining the integrity and reputation of ATF.

### **Enhance Controls Over the Information Security Management Function (Repeat Condition)**

During fiscal year 1996, ATF did not fully adhere to Federal requirements to provide for secure information system operations due to deficiencies in the information security management function. For example, the Program Manager for Information Systems Security is the only individual performing the information security function, which is insufficient staffing to implement and maintain a formal security program.

Secondly, ATF lacks formal security policies, standards, and procedures. ATF drafted security policies in September 1996, but has not distributed the final version. Without such a framework, information security may not be adequate.

Finally, ATF does not have a process to ensure that adequate security was provided for all agency general support systems and major applications. ATF has taken initial steps to establish a formal risk management process, but has not identified all of its major application systems. Further, the Bureau has not certified and accredited its major application systems as required by OMB Circular A-130, Management of Federal Information Resources. ATF plans to correct this situation by June 2000.

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### **Continue to Improve Effectiveness of Access Control Software (Repeat Condition)**

During the year, ATF corrected a number of previously reported conditions, making its access control software much more effective. The Bureau still needs to address three issues:

- While corrective action efforts are underway, the security software has yet to be fully integrated with the database management system. Until the corrective action is completed, access to sensitive database-resident information may not be adequately restricted.
- Application programmers have access to production programs and data files. Accordingly, application programmers could make unauthorized changes to production source code and data files thereby affecting application system integrity and reliability.
- The security software maintains inadequate audit trails. Specifically, successful and unsuccessful access attempts to certain sensitive resources are not captured. Without adequate audit trails, management cannot detect unusual or unauthorized activity in a timely manner.

### **Implement Adequate Separation of Duties (Repeat Condition)**

Application programmers could directly implement program changes into production, a lack of adequate segregation of duties. The current process does not ensure that program changes are consistently requested, authorized, and accepted. Failure to perform supervisory review and approval of modifications could result in erroneous or unauthorized changes. ATF is aware of these matters and has taken initial steps to develop and implement a standard program change control process.

### **Evaluate Telecommunications Security Risks**

ATF needs to evaluate its vulnerability arising from two aspects of its telecommunications operations. First, when individuals dial-in to the ATF computer network, they are required to enter a sign-on and password, the same level of security used for networked users. Dial-in capabilities, however, introduce additional risk, and may justify additional security measures to protect the stored data. Second, data transmitted over certain telephone circuits is not encrypted so as to prevent electronic eavesdropping. Consequently, confidential information could be compromised. ATF plans to assess alternate dial-in security solutions, and use encryption on all telecommunications circuits in the future.

### **Status of Prior Year's Financial Statements Audit Findings**

We followed up on the status of audit findings identified as reportable conditions in our report *Audit of the Bureau of Alcohol, Tobacco and Firearms Fiscal Year 1995 Statement of Financial Position* (OIG-96-059,

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May 2, 1996). Conditions that continued to exist and that we still considered as reportable conditions are identified in this report as Repeat Conditions. We also assessed the remaining conditions and the related corrective actions that were taken or were being taken. We deemed these corrective actions to be adequate in addressing these findings and, accordingly, we believe that none of the remaining conditions continues to be a reportable condition. We provided ATF with a document which discusses these conditions and related corrective actions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure over financial reporting and its operation that we will communicate to ATF's management separately.

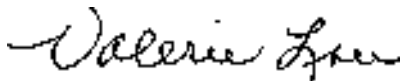
## COMPLIANCE WITH LAWS AND REGULATIONS

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatements, we tested compliance with those laws and regulations directly affecting the financial statements and certain other laws and regulations designated by OMB and ATF.

As part of our audit, we also obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (FMFIA) and compared material weaknesses in the Department of the Treasury's FMFIA report that relate to the financial statements under audit to the reportable conditions found during the evaluation we conducted on ATF's internal control structure. However, our objective was not to provide an opinion on overall compliance with these provisions or on overall compliance with laws and regulations.

We noted certain immaterial instances of noncompliance that we will communicate to the management of ATF separately. Except as described above, the results of our tests disclosed no instances of noncompliance that are required to be reported herein by *Government Auditing Standards*, as issued by the Comptroller General of the United States.

We have reviewed our findings and recommendations with ATF's financial management and have incorporated their comments as appropriate. This report is intended for the information and use of the management of ATF, the Department of the Treasury, OMB, and the Congress. However, this report is a matter of public record, and its distribution is not limited.



Valerie Lau

Inspector General  
April 25, 1997